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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

KRISTIN K. MAYES, Chairman
 GARY PIERCE
 SANDRA D. KENNEDY
 PAUL NEWMAN
 BOB STUMP

2009 AUG -7 A 10: 50

AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
 SUNRISE WATER CO., AN ARIZONA
 CORPORATION, FOR A DETERMINATION OF
 THE CURRENT FAIR VALUE OF ITS UTILITY
 PLANT AND PROPERTY AND FOR
 INCREASES IN ITS RATES AND CHARGES
 BASED THEREON FOR UTILITY SERVICE

DOCKET NO. W-02069A-08-0406

NOTICE OF FILING
REPLY BRIEF

1 Sunrise Water Co. ("Sunrise") hereby files its Reply Brief in the above-captioned matter.

2 RESPECTFULLY SUBMITTED on August 7, 2009.

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2 on August 7, 2009, with:

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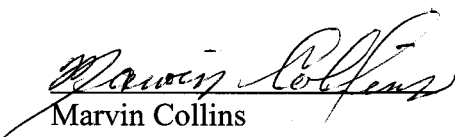
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SUNRISE WATER COMPANY'S REPLY BRIEF

1 **I. INTRODUCTION**

2 In their July 24, 2009, Initial Briefs, the Commission Staff ("Staff") and Sunrise Water
3 Company ("Sunrise") discussed each issue that has not been resolved in this case. In this Reply
4 Brief, Sunrise will address a few statements in Staff's Initial Brief.

5 **II. RATE BASE**

6 Sunrise stands by its discussion concerning the recovery of payments of known and
7 measurable refunds that it was legally obligated to pay as a result of its test-year water sales.
8 The Commission should reduce AIAC by \$64,178 and approve a rate base of \$1,248,012 for
9 Sunrise.

10 **III. OPERATING INCOME**

11 **A. HYDRANT-WATER SALES**

12 Sunrise stands by its discussion concerning why Staff's normalization method for
13 hydrant-water sales grossly overestimates the amount of such sales that will be made during the

1 period that rates will be in effect. The Commission should approve Sunrise's test-year
2 normalized hydrant-water sales of 8,189,208 gallons.¹

3 **B. OUTSIDE SERVICES**

4 Sunrise stands by its discussion concerning why it is appropriate to include 50% of the
5 cost of the services provided by SRW Consulting (\$13,500) in annual operating expense.

6 **C. BARN, WORKSHOP, STORAGE, FIELD OFFICE AND YARD RENTAL**

7 Staff states, without any evidentiary support, that it "believes the reported rent expense
8 far exceeds the market rate for the leased facilities."² Staff provided no such analysis, and, Mr.
9 Collins' undisputed testimony was that there were no other suitable facilities in Sunrise's largely
10 residential service territory. This made a market analysis impossible.³

11 As discussed at length in Sunrise's Brief,⁴ these facilities are also absolutely necessary.
12 The facilities are located on Mr. Campbell's property, which is a fenced and occupied, large
13 acreage, ranch-style, residential property, with a single source of ingress and egress. These
14 features provide excellent security and protect the items from theft and damage. The supplies,
15 material, tools, and equipment stored at these locations include brass fittings and copper tubing,
16 hand tools and power equipment, and other miscellaneous water facilities piping and fittings.
17 These types of items are highly susceptible to theft and vandalism. The area also provides a
18 safe, secure area to park utility vehicles overnight and on weekends. This protects them from
19 vandalism and makes them available for maintenance (vehicle washing, oil and fluid changes,
20 tire service, tune-ups, and other routine services) at the nearby workshop/barn. Finally, the
21 workshop in the barn is used by field crews to make repairs and to perform other equipment
22 functions, and the field office is used for field crew meetings and staging.

¹ Sunrise agrees that the adjustments to purchased power expense is due solely to their different estimates of "normal" hydrant-water sales.

² Staff Brief at 6:11-12.

³ Tr. at 49:9 – 50:11.

⁴ Sunrise Brief at 8 – 12.

1 It is undisputed that a water utility must own or lease these types of facilities. A cost of
2 just over \$3,000/month is more than reasonable, particularly when there are no other such
3 facilities available in or near the service territory.

4 Sunrise stands by its discussion of why the Well No. 7 site could not be used for these
5 types of necessary utility purposes.

6 Staff also ignored the recent West End Water Co. rate case, Docket No. W-01157A-06-
7 0004, Decision No. 68925 dated August 29, 2006, where the Commission included expenses of
8 \$12,286.00 for rental expense for these facilities, for a much smaller company.

9 **D. RATE CASE EXPENSE**

10 Sunrise generally stands by its discussion of why \$90,000 is an appropriate level of rate-
11 case expense. However, it was misleading for Staff to state that “over the course of this matter,
12 the issues have been narrowed.”⁵ Yes, the parties were able to narrow the issues, but two of the
13 remaining issues—hydrant water sales, and particularly, income-tax expense—have turned out to
14 require far more analysis and testimony than Sunrise anticipated when it prepared its estimate of
15 rate-case expense. In fact, as Mr. Jones testified, Sunrise had no idea that Staff would challenge
16 recovery of income-tax expense until three days before Staff’s testimony was due.⁶

17 There was no way that Sunrise could possibly have budgeted for dealing with such a
18 contentious issue. More than one-third of Sunrise’s prefiled testimony in this case was devoted
19 to just the income-tax issue:

Exhibit No.	Description	Total Pages (Not Including Attachments)	Total Pages Devoted to Income-Tax Issue
A-5	Jones Direct	15	0
A-2	Collins Direct	5	0
A-6	Jones Rebuttal	20	5
A-3	Collins Rebuttal	19	4
A-7	Jones Rejoinder	19	9
A-4	Collins Rejoinder	7	1
A-15	Jones Supplemental	16	16
	Total	101	35

⁵ Staff Brief at 11:17.

⁶ Exhibit A-15 at 13:11-15.

1 A large portion of the hearing, including an additional hearing day, also concerned the
2 unexpected income-tax issue. Sunrise estimates that approximately one-third of the transcript
3 concerns this issue.

4 It was also misleading for Staff to state: "Even as of the rejoinder testimony, the
5 Company admits that it has only spent \$64,500 of the original \$75,000 budget."⁷ Although Staff
6 did not provide a reference, Sunrise believes that Staff was referring to the following section of
7 Mr. Jones's Rejoinder Testimony, which deserves to be quoted in full:

8 Through month-end March 2009, Sunrise has expended approximately \$64,500 in
9 rate case expenses. To finish the case Sunrise needed to continue to engage a
10 consultant and attorney to analyze Staffs surrebuttal testimony, prepare and file
11 rejoinder testimony, prepare for hearing, participate in the hearing, prepare
12 closing briefs and attend Open Meeting. Sunrise estimates this additional expense
13 will be approximately \$25,500, for a total rate-case expense of \$90,000.⁸

14 First, this figure clearly did not include the costs associated with preparing rejoinder testimony.

15 In fact, as of the end of March, Sunrise only had \$10,500 in its budget left to continue to engage
16 a consultant and attorney to analyze Staffs surrebuttal testimony, prepare and file rejoinder
17 testimony, prepare for hearing, participate in the hearing, prepare closing briefs, and attend Open
18 Meeting.

19 Mr. Jones' estimate of approximately \$25,000 in additional expense also did not include
20 consultant and attorney costs associated with researching, drafting, and presenting Supplemental
21 Direct Testimony on the subject of income-tax expense, or the additional hearing date. Sunrise
22 is now confident that its actual rate-case expense will exceed \$100,000.

23 For all these reasons, the Commission should approve recovery over three years of
24 \$90,000 in rate-case expense.

25 **E. INCOME-TAX EXPENSE**

26 Sunrise will not add much to its discussion of this issue. It is important to note that
27 Sunrise is not claiming that the Commission is required by law to allow recovery of this expense.

⁷ Staff Brief at 11:18-19.

⁸ Exhibit A-7 at 18:14-19.

1 Sunrise's assertion is that it would be poor public policy to allow large C-Corps to recover
2 hypothetical income-tax expense and to not allow small water S-Corps or LLCs to recover such
3 expenses. The equities are identical. In each case, the regulated entity is not the entity that pays
4 the allowed income-tax expense; rather, the regulated entity passes income-tax liability on to the
5 ultimate taxpayer, who must make the required income-tax payments.

6 In the case of both an S-Corp or a C-Corp that is part of a holding company (as most are
7 in this state), it is the ultimate shareholder that pays the taxes, and the actual tax liability is not
8 generally calculated as part of as a rate case.⁹ There is no justifiable reason that the Commission
9 should allow APS, Southwest Gas, Arizona-American Water, or Tucson Electric to recover
10 hypothetical tax expense and to deny Sunrise such recovery.

11 As recognized by many other courts and commissions, income-tax expense is a genuine
12 cost of doing business as a regulated utility. The Commission came to this same conclusion in
13 the 1997 case of Camp Verde Water System, Inc., Decision No. 60105, dated March 19, 1997.
14 In this case the Commission allowed recovery of income-tax expense by an S-Corp where the
15 bank would not loan funds if income-tax expenses were not allowed. This highlights the
16 economic reality that S-Corps have real income tax expenses. Because the bank's investment
17 would only be repaid with after-tax dollars, it insisted on recovery of income-tax expense in
18 rates. The Commission acknowledged economic reality and allowed Camp Verde to recover
19 expected income-tax expense.

20 Put another way, only the funds left over after paying taxes and other business expenses
21 are available to fund additional plant investment. If income-tax expense were not recoverable,
22 the effect would be to reduce the allowed return on equity and diminish the funds available for
23 plant investment.¹⁰
24

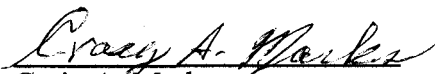
⁹ Although this information has been provided for Sunrise's shareholder as part of this case. Exhibit A-15 at 16:17-23.

¹⁰ Exhibit A-2 at 16 – 19.

1 **IV. RATE DESIGN**

2 Sunrise has nothing to add to its discussion of this topic in its Brief.

3 RESPECTFULLY SUBMITTED on August 7, 2009.

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